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Moscow and regions share Russia's oil and gas revenues

"Have-not" regions press Moscow for a share of oil and gas revenues.

BY *GALINA KURLYANDSKAYA*
Galina Kurlyandskaya *is the director-general of the Center for Fiscal Policy in Moscow, a post she has held since 2000. She received her PhD from the Institute for World Economy and International Relations in Moscow in 1980.*
Photo: Kinef Corporation

The Russian Federation shares first place with Saudi Arabia in terms of extraction of hydrocarbon raw materials (oil and gas) in the world. Oil and gas production account for about nine per cent of Russia's Gross Domestic Product — $70 billion U.S.

The extraction of hydrocarbons is subject to taxes that are applied to mining operations, while their sale abroad is subject to export duties. Extraction of oil and gas is being carried out in 39 of Russia's 83 regions.

About 90 per cent of Russia's gas production is concentrated in the Yamalo-Nenetskiy Autonomous Area, while almost 60 per cent of oil production is carried out in the neighbouring regions: the Khanty-Mansiyskiy and the Nenetskiy Autonomous Areas. These regions are situated in the north of the European part of Russia and in the north of Western Siberia (see map). They account for 8.5 per cent of the territory of Russia and a mere 1.3 per cent of the country's population.

Export duties on oil and gas, like all other customs duties in the Russian Federation, accrue exclusively to the federal government. However, several federal taxes, such as those on mining operations (including oil and gas), are shared between the federal and regional budgets. This sharing of those tax revenues is carried out on a derivation basis: an equal share of revenues in all regions accrues to regional budgets in proportion to the amount of taxes paid by the taxpayers registered in each region.

Taxes on mines split with producing regions

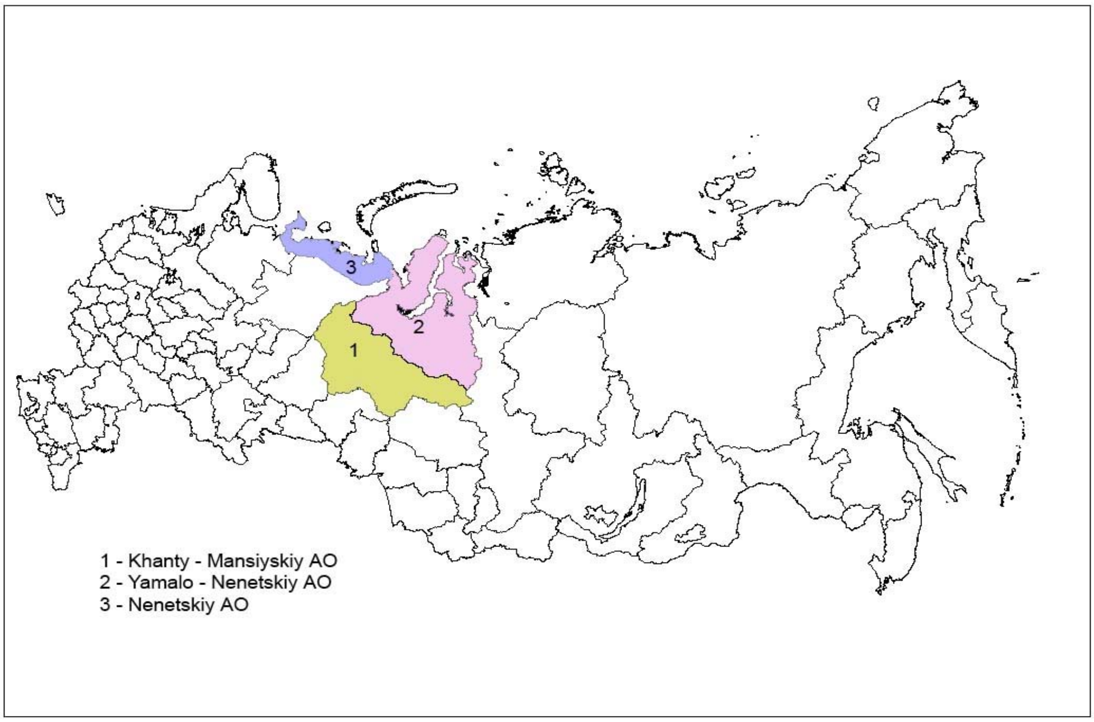
Until 2002, 60 per cent of taxes levied on mining operations, 39 billion rubles (about $1.3 billion U.S.), accrued to the budgets of mineral-producing regions, while 40 per cent, 26 billion rubles (about $900 million U.S.) accrued to the federal budget. As a result, even with the relatively low oil and gas prices prevailing at the time, the per-capita tax revenue of the three principal oil-producing regions in 2001 exceeded by almost five times the average tax revenue of the other Russian regions.

These large revenue disparities were only partially offset by disparities in expenditure needs. The cost of living in the oil- and gas-producing regions is only one and a half times greater than the mean Russian level – reflecting thesevere climate and the limited availability of transportation. A considerable proportion of the population of these regions, notably those working in the oil-and gas-producing industries, view themselves as temporary residents, and some production work is carried out completely on a rotational basis. As a result, the need to create and maintain a social infrastructure and to provide public services is relatively smaller in oil-and gas-producing regions than elsewhere. Overall, budgetary revenues in these regions considerably exceeded reasonable budgetary requirements – even after taking into account the high cost of providing public services – and led to ineffective expenditures.

Gas price increases boost revenues

With the increase in oil and gas prices in recent years, the budgetary revenues of oil- and gas-producing regions grew even larger and the federal government decided to change the mining tax sharing ratio between the central authority and the regions in its favour. In 2002, the share of taxes on oil production accruing to regional budgets fell from 60 per cent to 20 per cent; in 2003, the share declined to 15 per cent and, in 2005, to five per cent. Since 2004, tax revenues from natural gas production have accrued exclusively to the federal budget.

Fig. 1. Major Oil and Gas Producing Regions in the



The decision to centralize tax revenues from oil and gas production at the federal level was dictated by several factors. First was the need to curb the growth of budgetary expenditures caused by the increase in windfall revenues from the climb in prices for oil and gas, and the resulting inflationary pressure on prices. To "freeze" a part of these windfall revenues, the federal government set up a Stabilization Fund as part of the federal budget, effective Jan. 1, 2002. This fund has been one of the principal instruments for holding down excessive liquidity, lowering inflationary pressure and decreasing the dependence on volatile revenues from the export of raw materials. The fund accumulates the revenues derived from the portion of export duties on oil and from the tax on oil production that corresponds to the price for oil of the Urals grade exceeding $27 U.S. per barrel. As a result, 15 per cent of current revenues now accrue to the Stabilization Fund, 55 per cent to the federal budget and 30 per cent to subnational budgets.

Disparities among Russia's regions

The second factor in the centralization of tax revenues from oil and gas production was the growth in horizontal revenue disparities among the regions, and the resulting pressure on the federal government to equalize those disparities by means of vertical transfers, in this case payments to the regions from the federal government. Horizontal equalization – taking revenues from "rich" regions and turning them over to "poor" ones – is not practiced in the Russian Federation; equalization transfers flow into less affluent regions only from the federal budget. The federal budget therefore needed additional resources with which to fund increasing equalization transfers required by growth in horizontal disparities.

Also playing no small role in the centralization of mining taxes was the federal government's refusal to impose unfunded mandates on regional budgets and its adoption, starting in 2005, of an obligation to specify how such mandates are to be funded in all regions, taking into account their financial well-being. The provision of cash and non-cash benefits to such categories of the population as veterans of the Second World War, invalids, victims of the Chernobyl disaster, etc. is an example of the kind of mandate covered by this obligation.

Today, the tax on oil production generates 630 billion rubles (about $23 billion U.S.) which equals 12.5 per cent of federal revenues while the tax on gas production produces 92 billion rubles (about $3.5 billion U.S.) or 1.9 per cent of federal revenues. Export customs duties on oil make up another 16.2 per cent of federal revenues, generating 820 billion rubles (about $30 billion U.S.), while those on gas account for 5.3 per cent of federal revenues or 270 billion rubles (about $10 billion U.S.).

In the principal oil- and gas-producing regions, mining taxes currently account for
• 27.8 per cent of budgetary revenues in the Khanty- Mansiyskiy Autonomous Area, or 26.5 billion rubles (about $1 billion U.S.);
• 16.5 per cent of budgetary revenues in the Nenetskiy Autonomous Area, or 1.3 billion rubles (about $47 million U.S.), and
• 7.4 per cent of budgetary revenues in the Yamalo- Nenetskiy Autonomous Area, or 5.2 billion rubles (about $193 million U.S.).

Mining revenues centralized

Centralization of the revenues from mining operations conforms to the notion that mineral resources should belong to the Russian nation as a whole, and that tax revenues on their extraction, which are in essence economic rents, should therefore not be concentrated in individual regions, but utilized in the interest of the entire population. The centralized resources from mining taxes are in particular used by the federal government to decrease regional disparities, although there is no direct tie-in of these resources to the transfers directed into the regional budgets.

The total amount of all kinds of transfers passed on from the federal budget into the regional budgets comprises about half of the total revenues from oil and gas that flow into the federal budget. Oil and gas revenues are thus used to equalize the budgetary revenues of the regions and deliver on constitutional guarantees to the population in all regions of Russia.

Investments made from the Stabilization Fund are another instrument whereby federal budgetary revenues from oil and gas are used in the interest of the entire population. In accordance with the legislation governing the Fund, accumulated amounts in excess of $20 billion (a threshold that was surpassed in 2005) may be used by the federal government at its discretion. By decision of the federal government in 2006, an Investment Fund was established in the Russian Federation to direct resources of the Stabilization Fund to state support of investment projects of national importance.

Investment fund grew from $2.5 billion

The initial size of the fund was $2.5 billion U.S. The selection of projects for state support should be carried out on a competitive basis. The projects should be directed to such goals as increasing employment levels, improving the quality and availability of public health and educational services, increasing housing for the population, improving the transportation infrastructure, the reconstruction and construction of projects in the communal infrastructure (gas- and water-supply systems, heating systems, etc.) and improving the environment. Thus, the resources of the Stabilization Fund, endowed by the taxes from oil and gas extraction, will ultimately be directed to decreasing regional disparities in living standards.

In conclusion, it is interesting to note that, despite the almost complete centralization of revenue from taxes on mining operations in the federal budget, high prices for oil and gas still allow oil-and gas-producing regions to raise significantly greater per-capita budgetary revenues than in other regions. This is achieved through the tax on the large profits of the oil- and gas-producing companies, and income taxes collected from the high wages of workers involved in oil and gas production. All income taxes paid by workers of these companies within a given region flow into the budget of that region, as does a portion of the taxes on profits of these companies, at a rate ranging from 13.5 per cent to 17.5 per cent. As a result, the Autonomous Areas of Nenetskiy, Yamalo-Nenetskiy and Khanty- Mansiyskiy rank first, second and third among Russian regions in terms of revenue per-capita.

Fig.2. Dynamics of Oil&Gaz Taxes versus Export Duties (% GDP)